No. 733

IN THE

Supreme Court of the United States

OCTOBER TERM, 1924

BLAKELY D. McCAUGHN, United States
Collector of Internal Revenue,

Petitioner

v.

CHARLES H. LUDINGTON,

Respondent

PETITION FOR REHEARING
of Charles H. Ludington, Respondent

HUGH SATTERLEE,
WILLIAM R. PERKINS,
RALPH B. EVANS,
Of Counsel for Respondent

TABLE OF CASES CITED.

ADDITIONAL CITATIONS.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1924.

No. 733—CERTIORARI TO A JUDGMENT OF THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BLAKELY D. MCCAUGHN, United States Collector of Internal Revenue,
Petitioner,

vs.

CHARLES H. LUDINGTON,
Respondent.

PETITION FOR REHEARING

TO THE HONORABLE THE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Charles H. Ludington, respondent in this cause, respectfully moves the Court for a rehearing, upon the grounds stated below.

Summary of Grounds for Rehearing.

1. The present *Flannery* and *Ludington* decisions reverse all the contemporaneous Treasury regulations under the 1916 and 1918 Acts regarding **loss from sale** (p. 4).

2. The Treasury regulations under the 1916 Act, so reversed, were ratified and adopted by the 1918 Act (p. 5).

3. The present decisions conflict with *Goodrich* v. *Edwards,* which decided that cost or March 1, 1913 value, **whichever is higher**, should be the basis for determining **gain.** The same basis should be applied in determining **loss from sale** (p. 5).

4. The present decisions conflict with *Lynch* v. *Alworth-Stephens Company,* decided by this Court March 2, 1925, which allowed **loss from depletion** based on March 1, 1913 value **higher than cost** (p. 7).

5. The present decisions conflict with the Treasury regulations under the 1916 and 1918 Acts, which allow **loss from depreciation** based on March 1, 1913 value **higher than cost** (p. 8).

6. The present decisions conflict with the Treasury regulations under a similar provision of the 1921 Act, which allow **loss from casualty** based on March 1, 1913 value **higher than cost** (p. 11).

7. The case of **loss from sale** is the only situation in which taxpayers have been denied the benefit of March 1, 1913 value **higher than cost** (p. 12).

8. The present decisions disregard the reference in Section 202 (a) to **inventory value,** which expressly sanctions a basis **more favorable than cost** (p. 14).

9. The present decisions conflict with the intention of Congress to preserve to every taxpayer the full benefit of capital value at March 1, 1913 (p. 15).

10. Losses from March 1, 1913 value are actual losses (p. 16).

11. The present decisions create inequality and tend to confusion in the administration of the revenue acts (p. 17).

12. The present decisions conflict with the Court's doctrine that any doubt in the statute should be resolved in favor of the taxpayer, which requires that the same basis be adopted for **loss from sale** as for **gains** and for losses from **depreciation,** from **depletion,** and from **casualty** (p. 19).

The 1918 Act and the Present Decisions.

The question involved is the construction of **Section 202 (a) of the Revenue Act of 1918:**

> "That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203."

The Court has held in this case and in *United States* v. *Flannery,* No. 527, concurrently decided, that under §202 (a) the basis for ascertaining loss from sale of property acquired before March 1, 1913, is cost or March 1, 1913 value, **whichever is lower**. Mr. Justice McReynolds and Mr. Justice Sutherland dissented, and we are informed that Mr. Justice Stone did not participate in the decision.

The Court has thus reversed, by a vote of six to two, the unanimous judgments of the Circuit Court of Appeals in the present (*Ludington*) case and of the Court of Claims in the *Flannery* case. The present decisions also overrule the carefully considered determination of the Board of Tax Appeals in *Appeal of Even Realty Co.* (January 16, 1925), 1 B. T. A. 355, 364, and the decision in *Vance* v. *McLaughlin, Collector* (U. S. D. C. California, April 15, 1924), Prentice-Hall Federal Tax Service 1924, paragraph 2804B; Corporation Trust Company, Federal Income Tax Service 1925, paragraph 1549D.

Grounds for Rehearing.

1. The Flannery and Ludington decisions reverse all the contemporaneous Treasury regulations and rulings under the 1916 and 1918 Acts regarding loss from sale, which adopted March 1, 1913 value as the basis even where such value was higher than cost. The opinions make no reference to the regulations and rulings so reversed.

The rulings so reversed were relied upon in all business transactions from 1916 through 1920 (the years during which the 1916 and 1918 Acts were in effect) and in the audit of all returns for those years until July, 1921. In the *Flannery* case the Court said:

> "Decisions affecting the business interests of the country should not be disturbed except for the most cogent reasons."

The effect of the present decisions is retroactively "to neutralize a loss occurring after the incidence of the tax [March 1, 1913] by an admittedly non-taxable gain occurring prior to the incidence of the tax." *Holmes Federal Taxes* (Sixth Edition), p. 708 (criticizing the Government contention). Disallowing such losses works a retroactive forfeiture in the case of those taxpayers who relied on the uniform interpretations of the statute by the Bureau and by other authorities. These interpretations are fairly illustrated by the extracts and citations appended in Schedule A to this petition.

The *Goodrich, Brewster, Klauber, Keim* and *Bush* decisions, upon which the *Flannery* decision rests, were all rendered after December 31, 1920, when the provisions of the 1918 Act for ascertaining gain and loss had ceased to be effective.

The Acts of 1921 and 1924 do not present the question here involved, and no business interests could be adversely affected by a decision allowing the deductions for loss claimed in this case and in the *Flannery* case.

2. The Treasury regulations and rulings under the 1916 Act, reversed in the Flannery and Ludington decisions, were ratified and adopted by the 1918 Act.

The 1918 Act, containing provisions corresponding to those of the 1916 Act, was enacted by Congress on February 24, 1919, with full knowledge of the Treasury Department's uniform construction of the 1916 Act, ever since its enactment, as authorizing the deduction of losses on the basis of March 1, 1913 value, regardless of whether such value were higher than cost.

> *National Lead Company* v. *United States* (1920), 252 U. S. 140, 146.

See the regulations and rulings under the 1916 Act quoted in Schedule A appended to this petition, and particularly the questions and answers from the *Income Tax Primer* on page 24.

Even if the *Goodrich* case be deemed to limit loss deductions to losses from cost, and even if the differences in phraseology between the 1916 and 1918 Acts be disregarded, the *Goodrich* decision under the 1916 Act would not justify the *Flannery* and *Ludington* decisions under the 1918 Act, because the 1918 Act must be construed as adopting the existing regulations and rulings.

We submit, however, that the *Goodrich* decision is entirely in accord with our contentions.

3. Goodrich v. Edwards (1921), 255 U. S. 527, decided that cost or March 1, 1913 value, whichever is higher, should be the basis for determining gain. The same basis should be applied in determining loss.

In the *Goodrich* case this Court held that cost or March 1, 1913 value, **whichever was higher**, should be used as the basis for determining taxable gain. In the *Ludington* and *Flannery* cases the Court has assumed to give "a corresponding effect" to March 1, 1913 value in the case of taxable losses, but has in fact fixed a wholly

different basis, to wit, cost or March 1, 1913 value, whichever is lower.

Having regard to substance, the provision as to losses should be given the same effect and not "a corresponding effect" to that given in the case of gains.

The reason for a rule should determine the extent of its application. The exemption from income taxation of all capital values existing March 1, 1913 is equitable, and the further exemption, established by the *Goodrich* and *Brewster* cases, of cost (capital investment) may likewise be regarded as equitable. The considerations favoring such exemptions, however, do not justify giving the statute "a corresponding effect" in the case of losses by denying to taxpayers the benefit of their capital values existing March 1, 1913. The point actually decided in the *Goodrich* case (as distinguished from the observations of the Solicitor General) does not warrant such indirect impairment of March 1, 1913 values.

> *Doyle* v. *Mitchell Brothers Co.* (1918), 247 U. S. 179.
>
> *Lynch* v. *Turrish* (1918), 247 U. S. 221.
>
> *State ex rel. Bundy* v. *Nygaard* (1916), 163 Wisc. 307, 158 N. W. 87 (not cited on the original argument).

The *Nygaard* case was decided by the Wisconsin Supreme Court in the January Term, 1916, whereas the *Goodrich, Brewster* and New York decisions were rendered after 1920. In the *Nygaard* case the Court denied the right of the legislature to tax appreciation in capital values arising prior to the enactment of the first income tax law (1911), the Court saying:

> "In the judgment of the court all of this was capital, or, in other words, property. Its status was fixed. No part of it could be made into income by legislative enactment. It was subject to taxation as property under the uniformity rule, but not otherwise."

4. The Flannery and Ludington decisions are inconsistent with the decision of this Court in Lynch v. Alworth-Stephens Company, rendered March 2, 1925, and with the Treasury regulations and rulings under the 1916 and 1918 Acts, regarding loss from depletion, which agree in adopting March 1, 1913 value as the basis where such value is higher than cost.

The 1916 Act provided in Sections 5 and 12 for a reasonable allowance for depletion of mines and mineral wells, limiting the aggregate allowance to "the capital originally invested, or, in case of purchase made prior to March 1st, 1913, the fair market value as of that date."

The 1918 Act provided in Sections 214 and 234 for a reasonable allowance for depletion of mining and mineral properties, except

> "That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date."

These statutory provisions were uniformly construed by the Treasury Department to authorize the March 1, 1913 value as the basis of depletion deductions where such value, as was true in most cases, was higher than cost. Even after the decision of this Court in the *Goodrich case*, the Treasury Department made no change in its regulations relating to depletion.

The recent decision of this Court in **Lynch v. Alworth-Stephens Company** has confirmed and approved the Treasury Department's uniform construction of the provisions of the 1916 and 1918 Acts relating to loss from depletion, which differ in no material particular from the statutory provisions relating to loss from sale.

The intention of Congress, as interpreted by this Court in the *Alworth-Stephens* case and by the Treasury Department in all its regulations, is further indicated by the provision in Sections 214 and 234 of the Act of 1918 (immediately following the provision with respect to depletion above referred to) that in the case of mineral properties discovered by the taxpayer on or after March 1, 1913, in certain circumstances "the depletion allowance shall be based upon the fair market value of the property at the date of the discovery or within thirty days thereafter." This provision was unmistakably intended to give the taxpayer the benefit of a higher depletion base than cost or even March 1, 1913 value, and has been uniformly so construed by the Treasury Department.

This discovery provision is entirely inconsistent with the thought that Congress, in referring to losses, had in mind only so-called "actual losses" based on cost.

5. The Flannery and Ludington decisions are inconsistent with the Treasury regulations and rulings under the 1916 and 1918 Acts regarding loss from depreciation, which adopted March 1, 1913 value as the basis where such value was higher than cost.

The 1916 Act in Section 12 provided for the deduction from gross income of

> "All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade."

The Treasury regulations were at first not clear whether exhaustion, wear and tear (or in other words, depreciation) was intended to have the same basis as

losses from sales in the case of property acquired before March 1, 1913 (*i. e.*, the value on that date). But by Treasury Decision 2754, approved August 23, 1918, all doubts were set at rest, and it was specifically ruled that

> "A reasonable allowance for the wear and tear of property arising out of its use or employment in the business or trade is to be based on the cost of such property or on its fair market price or value as of March 1, 1913, if acquired prior thereto."

In *Law Opinion No. 612* of the Solicitor of Internal Revenue, dated August 15, 1918, on which Treasury Decision 2754, above referred to, was based, the Solicitor relied on the following passage from the opinion of this Court in *Doyle* v. *Mitchell Brothers Company* (1918), 247 U. S. 179:

> "When the Act took effect, plaintiff's timber lands, with whatever value they then possessed, were a part of its capital assets, and a subsequent change of form by conversion into money did not change the essence. * * *
>
> "It may be observed that it is a mere question of methods, not affecting the result, whether the amount necessary to be withdrawn in order to preserve capital intact should be deducted from gross receipts in the process of ascertaining gross income, or should be deducted from gross income in the form of a depreciation account in the process of determining net income. In either case the object is to distinguish capital previously existing from income taxable under the Act."

The 1918 Act provided in Sections 214 and 234 for a reasonable allowance for the exhaustion, wear and tear of property, but without expressly specifying any basis in the case of property acquired before March 1, 1913. The Treasury regulations, however, following the interpretation of the 1916 Act, uniformly construed this statutory provision in the light of the other provisions of

the Act with reference to the determination of losses, as authorizing the use of March 1, 1913 value as the basis for depreciation in the case of property acquired before that date. Such regulations have not been changed since the decision of this Court in the *Goodrich* case was handed down.

Thus, in all cases arising under the 1916 and 1918 Acts, where March 1, 1913 value was higher than cost, loss from depreciation has been allowed on the basis of the March 1, 1913 value, although **the only support for such construction of the law and for such practice has been the analogy of the provisions of those statutes relating to the determination of loss on sales of property.** These provisions the *Flannery* and *Ludington* decisions have now construed to limit the deduction of losses from sale to cost where the March 1, 1913 value was higher than cost. If no relief be had from this intolerable situation, the Treasury Department may attempt to revise its regulations with respect to depreciation under the 1916 and 1918 Acts and to reopen and redetermine all cases under those Acts against which the statute of limitations shall not already have run.

In a **Statement by Mr. A. W. Gregg (now Solicitor of Internal Revenue)** issued by the Treasury Department in explanation of the changes from the Revenue Act of 1921, proposed in the Treasury draft of the Revenue Bill of 1924, appears the following comment on what corresponded to the present Section 204 (c):

> "(8) The first part of subdivision (b) of the draft, that is, the part preceding the exceptions, does not correspond to any provision of the existing law, but is the same as the interpretation placed upon the existing law by the Department. **It provides that the basis of computing depreciation and depletion shall be the same as the basis of computing gain or loss from the sale of prop-**

erty, and represents what is obviously the correct rule, since the theory in setting a basis for depreciation and depletion is the same as in setting one for determining gain or loss from sale; that is, to insure a taxpayer a return of his capital free from tax."

The confusion which would arise from the use of a basis for loss from sale different from the basis for loss from depreciation is well illustrated by the *Appeal of Even Realty Company* (1925), 1 Board of Tax Appeals Reports 355, an extract from which is attached as Schedule B to this petition.

6. The Flannery and Ludington decisions are inconsistent with the Treasury regulations and rulings under the 1921 Act regarding loss from casualty, which adopted March 1, 1913 value as the basis where such value was higher than cost.

The 1918 Act provided in Section 214 for the deduction from gross income of loss from casualty. Regulations 45 under the 1918 Act provided in Article 141 that loss from casualty, as well as loss on the sale of property, should be based on the fair market value as of March 1, 1913, in the case of property acquired before that date. After the decision of this Court in the *Goodrich* case, Article 141 was amended by Treasury Decision 3206, approved July 8, 1921, to provide that loss from casualty, as well as from sale, should be based on cost where March 1, 1913 value was higher than cost.

The 1921 Act, in the case of loss from sale, embodied in elaborate language the rule now laid down by this Court in the *Flannery* and *Ludington* decisions, but in the case of loss from the destruction of property provided in Section 214 that "where the property so destroyed or damaged was acquired before March 1, 1913,

the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913." Regulations 62 under the Act of 1921 provided in Article 141 that **loss from the sale** of property should be determined in accordance with the rule now embodied in the *Flannery* and *Ludington* decisions, but that **loss from casualty** should be based on the March 1, 1913 value of the property, where acquired before that date.

Thus the Treasury Department admits, and no one disputes, that March 1, 1913 value is the basis **even where such value was higher than cost** under the following provision of the 1921 Act relative to loss from casualty:

> "where the property so destroyed or damaged was acquired before March 1, 1913, the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;"

although, after the decision of this Court in the *Goodrich* case, the Treasury Department reversed a like construction of the similar provision in the 1918 Act in respect of loss from sale, which required that the basis should be

> "in the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date".

7. The case of a loss from the sale of property acquired before March 1, 1913, is the only situation under any of the revenue acts in which taxpayers have been denied the benefit of capital value existing on March 1, 1913, in excess of cost.

As to gain from sale, under the 1916 and 1918 Acts the Treasury Department has uniformly ruled that the March 1, 1913 value of property acquired prior thereto was the basis if such value was higher than cost. This Court in the *Goodrich* case held, and the Treasury De-

partment thereafter ruled, that in all cases of gain from sale the basis should be cost or March 1, 1913 value, **whichever was higher.**

As to loss from depreciation and depletion, under both the 1916 and 1918 Acts the Treasury Department has uniformly ruled that the March 1, 1913 value of property acquired prior thereto was the basis, where such value was higher than cost. On the other hand, the Treasury Department has never limited taxpayers to the basis of March 1, 1913 value where cost was higher than such value, so that taxpayers have uniformly been allowed deductions for depreciation and depletion based on cost or March 1, 1913 value, **whichever was higher.**

As to loss from casualty, under both the 1916 and 1918 Acts the Treasury Department consistently ruled, prior to the decision of this Court in the *Goodrich* case, that the March 1, 1913 value of property acquired prior thereto was the basis where such value was higher than cost. After the decision of this Court in the *Goodrich* case the Treasury Department ruled, in assumed compliance with the principle of such decision, that cost was the basis for ascertaining loss from casualty where March 1, 1913 value was higher than cost; but the Treasury Department reverted to its original view in construing a provision of the 1921 Act relating to loss from casualty which was similar to the provision of the 1918 Act relating to loss from sale.

Following the decision of this Court in the *Goodrich* case the Treasury Department, which had opposed the concession of the Solicitor General with respect to the determination of gain, felt impelled to derive some advantage from that decision by attempting to limit loss from sale. This view it persuaded Congress to embody in the 1921 Act, then in course of passage. The complications resulting from a treatment of loss from sale at variance with the treatment of losses from depreciation, from de-

pletion and from casualty, however, brought about the omission from the 1924 Act of all the elaborate and illogical machinery for the determination of loss from sale differently from other losses and from gains, and the substitution, in Section 204(b) of the 1924 Act, of the simple and logical provision that the basis for determining **gain or loss** from the sale of property acquired before March 1, 1913, should be the cost or the fair market value as of March 1, 1913, **whichever was greater.**

8. The reference to inventory value in Section 202 (a) above quoted is a clear recognition of a basis which may result in loss greater than loss computed on a cost basis, and is inconsistent with the theory that Section 202 (a) contemplated only the deduction of what the Court calls "actual losses".

The 1918 Act provides that for the purpose of ascertaining the loss sustained from a sale of property the basis shall be, in the case of property acquired on or after March 1, 1913, the cost thereof, "or the inventory value, if the inventory is made in accordance with Section 203." Section 203, thus referred to, provides that whenever the use of inventories is necessary, they shall be taken upon such basis as the Commissioner may prescribe as conforming as nearly as may be to the best accounting practice and as most clearly reflecting the income. Pursuant to the authority so granted by Congress the **Treasury Department has sanctioned the taking of inventories at cost, or at cost or market whichever is lower, and in the case of dealers in securities even at market, although higher than cost.**

Consequently, if a dealer in securities takes his inventory at the beginning of the year at a market higher than cost, and his inventory at the end of the year at a lower market, which may still be higher than cost, he is

entitled to deduct the loss thus computed. Similarly, in the case of another merchant who takes his inventory at the beginning of the year at cost or market whichever is lower, and his inventory at the end of the year at a lower figure, because market value has dropped, he is entitled to deduct the loss thus computed, although he has not yet sold the goods at a price lower than cost.

Congress therefore had clearly in mind in drafting Section 202 (a) that losses computed pursuant to its provisions might often be greater than if limited to so-called "actual losses" on a basis of cost.

9. The Flannery and Ludington decisions are in direct conflict with the intention of Congress, which was to preserve to every taxpayer the full benefit of the capital value of his property at March 1, 1913.

The references to March 1, 1913 in the Revenue Act of 1916 originated in a single series of amendments covering not only loss from sales, but also losses from depreciation, depletion and casualty. In this connection Representative Kitchin, who was in charge of the bill as Chairman of the Committee on Ways and Means, said (53 Congressional Record, Part 11, p. 10727):

> "Mr. Kitchin. The constitutional amendment providing for an income tax went into effect on March 1, 1913, and we think that the value at that time, and not what was paid for it perhaps 10 or 15 years before the constitutional amendment took effect, should control."

This viewpoint of Chairman Kitchin was amplified in his discussion of a corresponding provision in the Revenue Bill of 1918 (56 Congressional Record, Part 10, p. 10350):

> "Mr. Kitchin. There is a very good reason. I assumed every gentlemen in the House, I thought

> even the gentleman from Texas, understood why we had to put March 1, 1913, into the statute, because before March 1, 1913, Congress had no constitutional power to levy an income tax. The income-tax amendment did not become effective until March 1, 1913. All gain, to which the gentleman referred, which had accrued before Congress had the power to pass an income tax could not be taxed, and therefore we had to say that in the case of property purchased before March 1, 1913, it matters not what its value, must be taken as of that date, because if I bought a piece of property of \$10,000 and on March 1, 1913, it was worth \$20,000, my income or profit is \$10,000, and as that gain accrued before Congress had the power to enact an income tax, it could not be taxed."

In the course of the same discussion Representative Fordney, who was also a member of the Committee in charge of the bill, said (*id.* 10352):

> "MR. FORDNEY. If you purchased a piece of property before March 1, 1913, you can take the value on that date as your investment in that property, and whatever you sell that property for over and above that value is income, on which you must pay the tax. Now, if you purchased it after March 1, 1913, there is no question as to its value. Its value is what you paid for it, and when you sell it this year the difference between what you paid for it and what you get for it is profit, and on that you pay an income tax. That is the law. I can not make it any plainer than that."

10. The Flannery and Ludington decisions appear to be erroneous in assuming that losses from March 1, 1913 value are not "actual losses".

It is respectfully submitted that the Court here overlooks the "time" or periodical element in the computation of income and losses; that where property has an actual market value on March 1, 1913, a subsequent sale for less than such market value involves an actual loss for

the period from March 1, 1913 to the date of sale; and that (whether or not losses from dates prior to March 1, 1913, would be deductible), there is no ground for denying deductions from March 1, 1913 values as not representing "actual losses".

A recognized purpose of the income tax is to apportion the tax burden in accordance with ability to pay. With this in view, it was equitable for Congress to start all taxpayers on a common basis at March 1, 1913, for computation of income and losses. A refusal to recognize losses from March 1, 1913 values creates arbitrary discriminations among taxpayers whose actual net incomes for a given period are identical. The present ruling of the Court in effect makes the deductibility of a loss depend on whether the taxpayer "realized" the appreciation of his property shortly before March 1, 1913, by exchange or sale and reinvestment, thus making the tax depend upon adventitious circumstances rather than upon changes in economic condition.

11. The Flannery and Ludington decisions create inequality and injustice and tend to confusion and uncertainty in the determination of tax liability under the 1916 and 1918 Acts and even under the 1921 Act.

The Revenue Acts of 1916 and 1918 were in force for the five years beginning with 1916 and ending with 1920. The decision in the *Goodrich* case was rendered on March 28, 1921, and Treasury Decision 3206, reversing the previous uniform practice with respect to the ascertainment of loss from sale, was promulgated on July 8, 1921. Meanwhile all income tax returns for the five years in question had been prepared and filed, and to a considerable extent audited and approved, on the principle of allowing losses based on fair market value as of March 1, 1913, even where such value was higher than cost.

Following the promulgation of Treasury Decision 3206, the Bureau proceeded to review the unaudited returns under the 1916 and 1918 Acts upon the new theory, and attempted to impose additional taxes accordingly. As the practically unanimous opinion of the Bar, however, was that the decision in the *Goodrich* case, prescribing the ascertainment of gain upon the basis of March 1, 1913 value or cost, **whichever was higher,** did not limit taxpayers to an allowance of loss based on March 1, 1913 value or cost, **whichever was lower,** taxpayers generally opposed the redetermination of their tax liability in accordance with Treasury Decision 3206, and have by protest and appeal within the Bureau, or by claims for abatement and refund, held their cases open pending a final decision by this Court.

If, then, no relief be had from the rule in the *Flannery* and *Ludington* cases, many taxpayers, on whose returns the statute of limitations has run, will have paid taxes in accordance with the contemporaneous construction of the statute by the Treasury Department; while many other taxpayers, whose returns were audited after the promulgation of Treasury Decision 3206 on July 8, 1921, and who have appeals or claims pending, will be obliged to pay additional taxes on the basis of the changed construction of the statute; and still other taxpayers, whose returns were audited and apparently approved before July 8, 1921, but in whose favor the statute of limitations shall not yet have run, will be subjected to a reopening of their returns and to the payment of additional taxes in respect of matters which they had every reason to suppose were settled. **On the other hand, the rule contended for by this petitioner would result in the adjustment of outstanding claims under the Acts of 1916 and 1918 in accordance with the basis employed in the audit of all returns previously reviewed and approved during the years in question and with the basis on which all returns for such years were actually prepared and filed.**

As already indicated, the uniform allowance of losses from depreciation and depletion by the Treasury Department upon the basis of March 1, 1913 value, where such value was higher than cost, was authorized, not only under the 1916 and 1918 Acts, but also under the 1921 Act, by statutory provisions similar to the provision in Section 202 of the 1918 Act here involved, and in the case of depreciation under the 1916 and 1918 Acts merely by analogy to loss from sale. If no relief be had from the rule in the *Flannery* and *Ludington* cases, the Treasury Department may readily conceive that throughout the period of eight years beginning with 1916 and ending with 1923, during which the 1916, 1918 and 1921 Acts were in force, it has erred in its allowance of depreciation and depletion upon the basis of March 1, 1913 value, where such value was higher than cost, and may reopen all returns and redetermine all tax liability against which the statute of limitations shall not yet have run.

12. The Flannery and Ludington decisions are inconsistent with earlier holdings of this Court that any doubt in the words of a taxing statute should be resolved in favor of the taxpayer.

In *United States* v. *Merriam* (1923), 263 U. S. 179, the Court said at page 187:

> "On behalf of the Government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer. *Gould* v. *Gould*, 245 U. S. 151, 153."

In the *Goodrich* case the Court resolved the doubt in favor of the taxpayer by establishing the basis of cost or March 1, 1913 value, **whichever is higher.** In the *Flannery* and *Ludington* decisions it has resolved the doubt in favor of the Government by establishing in the case of loss from sale the opposite basis of cost or March 1, 1913 value, **whichever is lower.**

Not only do the *Flannery* and *Ludington* decisions resolve doubts against the taxpayer, but in reversing the regulations these decisions in effect

> "impose an unexpected liability that if known might have induced those concerned to avoid it."
>
> *Lewellyn* v. *Frick*, No. 681, decided in this Court May 11, 1925.
>
> *Shwab* v. *Doyle* (1922), 258 U. S. 529.

We contend that in all computations of loss and gain under the 1918 Act the basis should be cost or March 1, 1913 value, whichever is higher. Such a uniform rule, now embodied in the 1924 Act, is consistent with the rule in the *Goodrich* case relating to gains, with the uniform practice of the Treasury Department relating to losses from depreciation, from depletion and (except for a brief period following the *Goodrich* decision) from casualty, and with an unforced and reasonable construction of the 1918 Act relating to loss from sale.

The rule for which we contend was adopted by Congress in the 1924 Act, which replaced the 1921 Act. This was done in accordance with Report No. 179 of the Committee on Ways and Means dated February 11, 1924, which said of this rule:

> **"It simplifies exceedingly the rule in effect under the present law without appreciable loss to the Treasury."**

WHEREFORE your petitioner respectfully prays that this cause be restored to the docket and that a rehearing

and reargument be ordered, and that such other and further relief be granted as may seem proper.

Dated, May 15, 1925.

CHARLES H. LUDINGTON,
by
HUGH SATTERLEE,
WILLIAM R. PERKINS,
RALPH B. EVANS,
Respondent's Attorneys.

I HEREBY CERTIFY that the foregoing petition is filed in good faith and not for the purpose of delay, and that in my opinion the relief therein prayed should be granted.

HUGH SATTERLEE,
Of Counsel.

SCHEDULE A.

Examples of Official Rulings under 1916 Act:

In *Regulations 33 (Revised)*, the last sentence of *Art. 116* (Paragraph 392) was as follows:

> "If a loss results from the sale of capital assets, the amount of the loss to be deducted will be ascertained in a like manner as if a gain had been realized, and will be the amount by which the selling price is less than the value, as of March 1, 1913, or less than the cost, if acquired subsequent to that date, as the case may be."

Regulations 33 (Revised), Art. 123 (Paragraph 411), was in part as follows:

> "* * * * the question as to whether profit or loss results from the sale will depend upon whether or not the value of the stock taken in payment for the assets is in excess of the fair market price or value as of March 1, 1913, of the assets sold or of their cost accordingly as they were acquired by the selling company prior or subsequent to that date."

Regulations 33 (Revised), Art. 157 (Paragraph 475), was in part as follows:

> "A corporation disposing of patents by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of March 1, 1913, if acquired prior to that date, or between the selling price and the cost, if acquired subsequent to that date."

Regulations 33 (Revised), Art. 168 (Paragraph 495), was as follows:

> "No deduction will be allowed for the depreciation of good will, trade-marks, and trade brands.

If such assets shall have been purchased at a determined price and shall be later sold at a price less than such cost, or less than their determined fair market value as of March 1, 1913, if acquired prior to that date, the amount by which the selling price is less than the cost or value, as the case may be, will be a loss deductible from the gross income of the year in which such assets were sold."

Treasury Decision 2740, approved June 24, 1918, was in part as follows:

"(b) In order to determine whether there has been gain or loss on a sale, and the amount of the gain, if any, in general under all three acts, an amount must be withdrawn from the gross proceeds sufficient to restore the cost of the property or the capital value that existed at the commencement of the period under consideration (either Jan. 1, 1909, or Mar. 1, 1913). . ."

In addition to its Regulations 33 (Revised), in January, 1918, more than a year before the enactment of the Revenue Act of 1918, the Treasury Department prepared for the convenience of taxpayers an "*Income Tax Primer*", which was issued as House of Representatives Document No. 841, Sixty-fifth Congress, Second Session. On the back of the front cover appeared the following notation:

"In the House of Representatives,
January 19, 1918.

ORDERED, that 38,910 copies of the Income Tax Primer, prepared by the Bureau of Internal Revenue for the information and assistance of taxpayers, be printed for the use of the House of Representatives and distributed through the folding room."

Questions 26 and 27, with their answers, appearing on page 9 of such Primer, are as follows:

"26. How am I to determine what amount of gain or profit derived from a sale of property is returnable for income-tax purposes?

If you acquired the property sold prior to March 1, 1913, you should take its fair market price or value as of that date, add thereto all amounts subsequently expended in making permanent improvements, then deduct the aggregate of all claims for depreciation in value of property claimed as deductions on previous returns, and the difference between the result thus obtained and the selling price is the amount to be reported under 'Gross income.'

If you purchased the property on or after March 1, 1913, the difference between its cost, plus all amounts subsequently expended for permanent improvements less depreciation previously claimed, and its selling price, is to be returned.

If the property came to you on or after March 1, 1913, as an inheritance, the difference between the appraised value placed upon it at that time plus all amounts subsequently expended for permanent improvements less depreciation previously claimed, and its selling price, is to be returned.

27. How is the value as of March 1, 1913, of property sold determined?

No method of determining this value can be stated which will adequately meet all circumstances. What that value was is a question of fact to be established by any evidence which will reasonably or adequately make it appear."

Question 82, with its answer, appearing on page 20 of such Primer, is as follows:

"82. How am I to determine what amount of loss, resulting from a sale of property, is allowable as a deduction?

The same method of computation should be followed as is outlined in the answer to the twenty-sixth question. If the result is a loss instead of a gain, that loss may be claimed as a deduction, if

it was connected with your regular business or trade, or during the same year you derived gains from other transactions entered into for profit but not connected with your regular business or trade in excess of the amount of your loss."

See also instructions on forms for tax returns for 1916 and 1917 at pp. 20-21 of Appendix to Brief for Respondent-Taxpayer.

Examples of Official Rulings under 1918 Act:

Regulations 45, Art. 141, until July 8, 1921, was in part as follows:

"In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition, or the fair market value as of March 1, 1913, if acquired before that date, less depreciation since sustained, and the price at which they were disposed of."

Regulations 45, Art. 87, was in part as follows:

"Property held by the taxpayer on March 1, 1913, is capital."

See also instructions on forms for tax returns for 1918, 1919 and 1920 at pp. 45-46 of Appendix to Brief for Respondent-Taxpayer.

Additional authorities on computation of losses:

As to depreciation and depletion:

Regulations 33 (Revised):
Paragraph 488.
Paragraphs 497-499 and 501.
Paragraphs 504, 508.
Paragraphs 538, 547.

Treasury Decision 2754, approved August 23, 1918.
Regulations 45, Articles 161 and 164.

See also:

Holmes Federal Taxes (Sixth Edition), p. 708.

Montgomery Income Tax Procedure (1924 Edition), note to p. 1006.

Commerce Clearing House Tax Service for 1923, Paragraph 71, note.

Standard Income Tax Service for 1923, Part One, Paragraph (747), p. 119.

SCHEDULE B.

In the *Appeal of Even Realty Company,* 1 B. T. A. 355, 356, 363 ff., decided by the United States Board of Tax Appeals on January 16, 1925 (after the argument in this case), the findings of fact were as follows:

> "The taxpayer, a Missouri corporation, had as its sole business the operation of an office building in St. Louis which it acquired, with the land upon which it stood, on June 4, 1909, at a total cost of \$41,942.36, and sold in 1920 for \$47,687.04. The evidence does not disclose the parts of the cost price attributable to land and building, respectively. On March 1, 1913, the property had a fair market value of \$35,000, of which \$11,800 was attributable to the land and \$23,200 to the building. The taxpayer on its books of account and in its returns under the Corporation Tax Act of 1909 and the Revenue Acts of 1913 and subsequent years, took no account of and claimed no deduction for depreciation, exhaustion, wear and tear or obsolescence of the building. In its income and profits tax return for 1920 the taxpayer reported as gain the difference between the cost of the land and building and the sale price thereof. On audit the Commissioner increased this gain by the equivalent of 2 per cent per annum on \$23,200 from March 1, 1913, to the date of sale, and determined a deficiency in tax accordingly in the sum of \$3,356.92."

The opinion of the Board was in part as follows:

> "This brings us to the question of the proper *basis* or starting point for the computation of the gain. The Revenue Act of 1918 provides that, in case of property acquired before March 1, 1913, the basis shall be the value on that date. But the Supreme Court has held in *Goodrich* v. *Edwards,* 255 U. S. 527, and *Walsh* v. *Brewster,* 255 U. S.

536, that if the cost were greater than the value on March 1, 1913, the taxpayer is entitled to use cost as a basis. These cases were decided upon a concession by the Solicitor General that the Constitution necessitated the conclusion reached, and though the Court did not say so in its opinions we feel that the conceded constitutional ground and not any rule of construction must have furnished the *ratio decidendi* of the Court's judgments. We are satisfied that Congress *intended* to make the March 1, 1913 value the basis for computing gain or loss. If the Constitution gives a taxpayer the right to recover the cost of his property, upon selling it, where that cost exceeds the March 1, 1913 value, before accounting for gain, it must follow that if he recovers the value of his property through deductions for exhaustion, wear and tear, and obsolescence, through writing of losses by casualty or theft, or otherwise, he must be entitled to the same capital recovery before accounting for profit thereon. It would be anomalous to say that the Constitution entitles a man to take out of his gross receipts from the *sale* of his property its cost to him, before reporting income, but that he is entitled to take out of his gross receipts from the consumption of the same property in producing his income, only a lesser sum (*c. f. Appeal of Grosvenor Atterbury,* 1 B. T. A. 169).

"The same considerations that lead us to the conclusion that adjustment for recoveries of capital by allowance for exhaustion, wear and tear, and obsolescence must be made in computing gain upon the sale of property, compel us to the belief that similar adjustments should be made to cost before comparing it with value on March 1, 1913, for the purpose of deciding which of them should be the *basis* for that computation. If the taxpayer recovered a part of the cost of his property before March 1, 1913, only the balance of that cost can properly be recoverable thereafter. The Constitution certainly does not entitle a taxpayer to recover any part of his cost more than once, before

becoming accountable for taxes upon his gain. If, after proper adjustment for partial recoveries, it appears that the cost exceeds the value at March 1, 1913, that adjusted cost rather than the March 1, 1913 value should be taken as the basis for all subsequent computations; if it be less than the March 1, 1913 value the latter is the proper basis. Thus, if a taxpayer in 1903 buys a building with a normal life of twenty years for $10,000, and recovers in rents one-half of that cost by 1913, he is entitled to recover thereafter through deductions or upon the sale of the property either $5,000 or the market value at March 1, 1913, whichever is higher. To allow more would be permitting him a double recovery of part of his capital investment before accounting for profit, and certainly the Constitution does not compel that."

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